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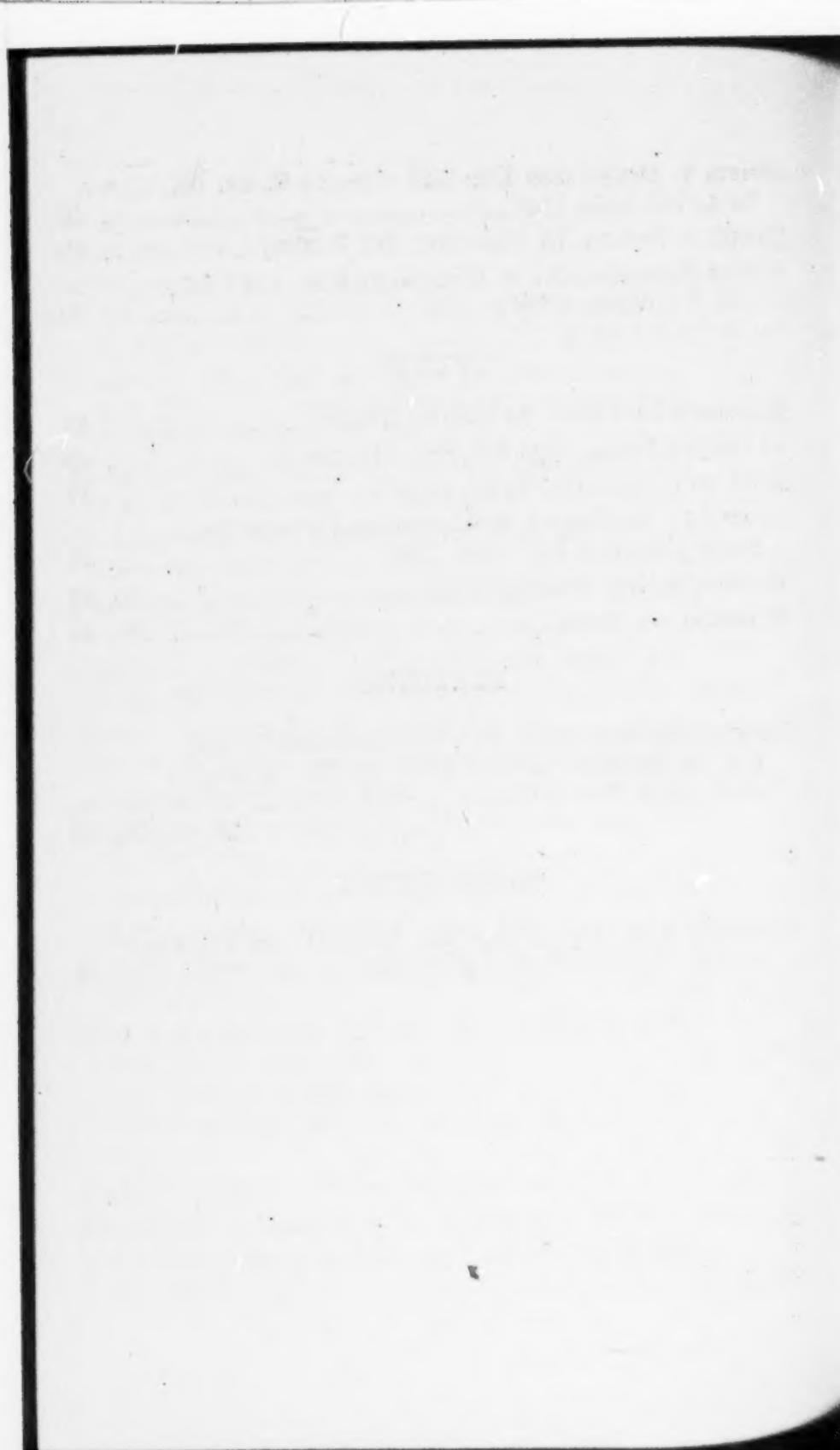
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SUPREME COURT
OF THE
UNITED STATES

OCTOBER TERM, 1947

No. _____

CONSOLIDATED GOLDACRES COMPANY
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS,
TENTH CIRCUIT.

The petition of Consolidated Goldacres Company, a Nevada corporation, respectfully shows:

SUMMARY AND SHORT STATEMENT OF MATTER INVOLVED.

The petitioner sued in The Tax Court of the United States for a redetermination of an alleged deficiency, in order to set aside the respondent's assertion of a "Corrected Excess Profits Tax Liability" for the taxable year

ended November 30, 1942, amounting to \$9,038.13. This liability the respondent claims exists, because in computing the excess profits tax credit, the respondent excluded the sum of \$221,476.59, being 50% of the average balance of a remaining indebtedness secured by written agreements. Petitioner contends that this sum is borrowed invested capital under Section 719 (b), evidenced by one of the specific instruments enumerated in Section 719 (a) (1), Internal Revenue Code, Title 26, U.S.C.A. The respondent disputes this; and the legal question thus raised is the only issue in the case. There is no dispute over facts or computations. The Tax Court ruled in favor of the respondent (R. 36; 8 T.C. 87). On review by the Circuit Court of Appeals, Tenth Circuit, the decision of the Tax Court was affirmed (R. 48; 165 F. (2d) 542, advance sheets of March 8, 1948). The present proceeding seeks a review and reversal by this court.

Contrary to the Congressional intention of said Section 719 (a) (1), I.R.C., the lower court erroneously held that the agreement in question, under which the taxpayer purchased a mill from a machinery house, does not qualify as any of the types of instrument evidencing indebtedness described in the section, and consequently that the \$221,476.59 is not "borrowed invested capital" under the provisions of Section 719 (b). The reduction in the excess profit tax credit, occasioned by wrongfully excluding this \$221,476.59 of borrowed invested capital as included in the excess profit tax return filed by the taxpayer, has resulted in reducing the excess profits tax credit to such an extent that a portion of the taxpayer's net income for the year ended November 30, 1942, would become taxable as excess profits.

The decision below is contrary to the recent decision of the Circuit Court of Appeals, Second Circuit, construing the same section 719 (a) (1), in *Brewster Shirt Company v. Commissioner*, 159 F. (2) 227, 229-30; and also is contrary to the decision in the Sixth Circuit by the District Court for the Western District of Kentucky in *Aetna Oil*

Company v. Glenn, Collector, 53 Fed. Supp. 961, construing a prior section of practically identical wording.

The decision below is also contrary to the decision of this court in *Chicago Railway Equipment Company v. Merchants National Bank*, 136 U.S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 352-3, which has never been modified or questioned, holding that such agreements are mortgages; and is also contrary to the decision of the Supreme Court of Nevada, where the mill is located, in *Nevada Motor Co. v. Bream*, 51 Nev. 89, 269 Pac. 602, 604-5, to the same effect.

JURISDICTIONAL STATEMENT

The jurisdiction of this court to review the decision of the United States Circuit Court of Appeals, Tenth Circuit, is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Title 28, U.S.C.A., Section 347 (a), for the following special and important reasons:

(a) The lower court herein has rendered a decision in conflict with the decision of the Circuit Court of Appeals, Second Circuit, in the *Brewster Shirt Company* case, *supra*, and in conflict with the federal decision in the Sixth Circuit by the District Court W.D. Ky. in *Aetna Oil Company v. Glenn, Collector*, 53 F. Supp. 961, *supra*, not questioned heretofore, on the same question or matter.

(b) The lower court has decided an important question of federal law which has not been, but should be, settled by this court, and said Section 719 (a) (1) has not yet been considered or construed by this court.

(c) The court below by its decision herein has decided an important federal question in a way in conflict with the applicable decision of this court in *Chicago Railway Equipment Company v. Merchants National Bank*, 136 U. S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 352-3, which has never been modified or questioned heretofore.

(d) The record presents an important federal question involving the Internal Revenue Code and public policy regarding security agreements in the purchase of machinery and equipment from machinery houses, pertaining to the national interest, which should be reviewed and decided by this court.

(e) The court below has in effect discriminated in favor of loans by banks and other money-lenders, and against loans by machinery houses on security, for productive purposes, evidenced in substantial compliance with Section 719 (a) (1).

OPINION OF THE COURT BELOW.

The case on appeal was heard by Judges Bratton, Huxman and Murrah. The opinion by Judge Murrah appears at R. 41-47 and is reported in 165 F. (2d) 542, advance sheets of March 8, 1948. On December 3, 1947, the taxpayer filed its petition for rehearing and brief in support thereof (R. 51-58), which petition was denied on January 14, 1948 (R. 59).

QUESTIONS PRESENTED

The questions presented involve the following points raised by the taxpayer:

1. The agreements Exhibits M and N (R. 4-17) between the petitioner and the machinery house created an absolute and unconditional obligation of the taxpayer to pay \$475,000.00, price of the mill. This obligation was unilateral from the moment the finished mill was finally accepted by the taxpayer. No method can reasonably be deciphered whereby its legal liability for the price could have been escaped by the petitioner.

2. The instruments Exhibits M and N (R. 4-17), made simultaneously and to be read together, are in effect the bond, note, bill of exchange, debenture or certificate of indebtedness intended by Congress in Section 719 (a) (1) Int. Rev. Code, 26 U.S.C.A.

3. These instruments creating a security arrangement, enforceable by foreclosure to retake the property on default, also constitute a mortgage or deed of trust under said Section 719 (a) (1).

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

(a) The lower court has construed the Internal Revenue Code, Section 719 (a) (1) 26 U.S.C.A. contrary to a recent decision of the Second Circuit construing this same section to-wit:

Brewster Shirt Company v. Commissioner of Internal Revenue, 159 F. (2d) 227, 229-30.

The lower court, referring to the *Brewster* decision, in contrast to its own decision herein, says:

"It may be that the philosophy of the two cases are incongruous."

165 F. 2d 542, 546, advance sheets.

(b) The lower court has also construed and applied said section contrary to the decision in the Sixth Circuit by the District Court for the Western District of Kentucky on the essentials of a note, in *Aetna Oil Co. v. Glenn, Collector*, 53 F. Supp. 961-966.

(c) The decision of the lower court is contrary to the decision of this court on the essentials of a mortgage in *Chicago Railway Equipment Company v. Merchants National Bank*, 136 U.S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 352-3.

(d) The lower court in its decision herein has been guided by labels and forms in the agreements Exhibits M and N (R. 4-17) rather than by contents, substance and effect.

(e) The lower court has erred in ruling that Exhibits M and N do not meet the requirements of any or all of the instruments enumerated in Section 719 (a) (1), and

holding that the \$221,476.59 is not borrowed invested capital evidenced as required by said section.

PRAYER

WHEREFORE your petitioner prays that a Writ of Certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals, Tenth Circuit, commanding said court to certify and send to this Court the transcript of record in the above entitled cause, being No. 3511 in that court, and that the record and judgment of said court be considered according to the rules and practice of this Honorable Court, to the end that said cause may be reviewed and determined, and that the judgment of the United States Circuit Court of Appeals, Tenth Circuit, be reversed and the cause remanded for further proceedings according to law, and that your petitioner have such other and further relief as to this court may seem just and proper in the premises.

CONSOLIDATED GOLDACRES COMPANY,
Petitioner,

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SUPREME COURT
OF THE
UNITED STATES

OCTOBER TERM, 1947

No. _____

CONSOLIDATED GOLDACRES COMPANY
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF
CERTIORARI.

OPINION OF THE COURT BELOW

The opinion of the Circuit Court of Appeals, Tenth Circuit, dated December 12, 1947, appears at R. 41-7, and is reported in 165 F. (2d) 542, advance sheets, March 8, 1948.

GROUND ON WHICH JURISDICTION OF SUPREME
COURT OF UNITED STATES IS INVOKED.

Judgment of the Circuit Court of Appeals, Tenth Circuit, was entered on December 12, 1947 (R. 48), and sus-

tained an alleged deficiency in the petitioner's corporate excess profits tax for the fiscal year ended November 30, 1942. Petition for rehearing and supporting brief (R. 51-58) were duly filed. Petition for rehearing was denied on January 14, 1948 (R. 59). Petition for writ of certiorari, *supra*.

Judgment of the lower court is based on its construction of the Internal Revenue Code, Title 26, U.S.C.A., Sec. 719 (a) (1). The jurisdiction of this Court is invoked under Sec. 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, Title 28, U.S.C.A., Sec. 347(a).

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code, Sec. 719 (as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974), viz.:

BORROWED INVESTED CAPITAL

(a) *Borrowed Capital*.—The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest, * * *) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage or deed of trust, * * *

(b) *Borrowed Invested Capital*.—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day.

(26 U.S.C. 1940 ed. Supp. V, Sec. 719).

Treasury Regulations 109, promulgated under the Internal Revenue Code, as amended by the Second Revenue Act of 1940:

Sec. 30.719-1 (as amended by T. D. 5267, 1943 Cum. Bull. 738).

Borrowed invested capital—The borrowed invested capital for any day of the taxable year is 50 per cent of the borrowed capital for such day determined as of the beginning of such day.

Borrowed capital is defined to mean:

(a) Outstanding indebtedness (other than interest and, in the case of taxable years beginning prior to January 1, 1941, for which the taxpayer has not elected under the provisions of section 230 (d) of the Revenue Act of 1942 to make the provisions of section 760 applicable, other than indebtedness described in section 751 (b) relating to certain exchanges, but including indebtedness assumed or to which the taxpayer's property is subject) of the taxpayer which is evidenced by a bond, a promissory note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus

(b) * * *

In order for any indebtedness to be included in borrowed capital it must be bona fide. It must be one incurred for business reasons and not merely to increase the excess profits credit. * * *

STATEMENT OF THE CASE

This proceeding was instituted by a petition in the Tax Court of the United States (R. 1-18) for redetermination of an alleged deficiency, in order to set aside the respondent's assertion of an excess profits tax liability for the year ended November 30, 1942. In computing the excess profits tax credit, the respondent excluded the sum of \$221,476.59, which was 50% of the average balance of a then remaining indebtedness secured by the written agreements Exhibits M and N (R. 4-17). Petitioner contends that this sum is borrowed invested capital under

Section 719 (b), evidenced by one of the instruments described in series in Section 719 (a).

This contention is disputed by respondent, and presents the only issue. All facts and computations are agreed upon (R. 19-20). The Tax Court held for respondent on January 21, 1947 (R. 36; opinion, R. 30-36). Petition for rehearing (R. 36-37) was duly filed and denied by the Tax Court on February 24, 1947 (R. 36). A petition for review was duly filed in the Circuit Court of Appeals (R. 37-40), resulting in judgment affirming the Tax Court (R. 48). Petition for rehearing (R. 51-58) being denied by the Circuit Court of Appeals on January 14, 1948 (R. 59), mandate issued in accordance with the opinion and judgment on January 26, 1948 (R. 59).

The alleged deficiency in dispute hinges on the construction of Section 719 (a) (1) and whether the agreement at bar, expressed in Exhibits M and N (R. 4-17), when considered in their legal effect and not by captions or forms, falls within any of the instruments enumerated in Section 719 (a) (1). The agreement was entered into on July 26, 1941, for the erection and purchase of a cyanide plant and Diesel electrical power plant connected therewith, on lands of petitioner about thirty miles south of Beowawe, Nevada (R. 9-10). Exhibit M refers to the machinery house Western-Knapp Engineering Co. as the Seller and to the petitioner Consolidated Goldacres Company as the Buyer. Exhibit N refers to Consolidated as Owner and to Western-Knapp as Contractor (R.9). For convenience herein, petitioner will be sometimes referred to as Consolidated and the machinery house as Western-Knapp.

Exhibit M (R. 4-9) briefly sets forth that Western-Knapp agrees to sell and Consolidated agrees to buy, and Western-Knapp will construct and install, the plant on Buyer's mining property. Consolidated shall pay the total sum specified in Exhibit N of even date (\$475,000.00, R. 11) and may pay sums in excess of monthly installments.

The Buyer will pay reasonable costs of collection or enforcement and reasonable attorneys' fees. Title and ownership shall continue vested in Western-Knapp regardless of attachment to realty, until full payment, at which time ownership shall pass to Buyer, and Seller shall execute at that time a good and sufficient bill of sale to all property. The property (except as provided in paragraph 11 of Exhibit N, R. 15) shall be kept at the exclusive risk and loss of Buyer, and any loss or destruction shall not release the Buyer in any manner. Any default in payment or otherwise by Buyer, or any attempt to remove, sell, encumber, etc., or failure to keep in repair, or voluntary or involuntary bankruptcy, shall cause the full amount of indebtedness to fall due and, if not cured within 90 days after notice, the Seller may, without legal process, enter, take possession and make such disposition as Seller sees fit, retaining all prior payments as consideration for use and not as a penalty, or Seller may sell, with or without notice, at public or private sale, at which sale Seller may purchase and credit the proceeds less expenses on the amount remaining unpaid, or without sale may credit the fair market value at time of repossession, and "Buyer hereby agrees to pay forthwith any balance thereafter remaining unpaid hereunder" (R. 7). Buyer will pay all taxes, assessments, etc., and keep the property free and clear of liens and encumbrances of any description, and the Buyer expressly waives all provisions of law requiring any sum to be repaid to it or that any of the property be sold at public or private sale or any part of the proceeds accounted for or paid over to Buyer; the Seller may inspect; the Seller shall not be liable for damages in any way connected with the property, and Buyer shall indemnify Seller from such damage; and time shall be of the essence (R. 4-8).

Exhibit N (R. 9-17), terming Consolidated the Owner and Western-Knapp the Contractor, provides for the construction and installation of the cyanide plant and Diesel electrical power plant connected therewith; with the work, materials and equipment to be furnished to the satisfac-

tion of one Hazen, representative of Owner, referred to as Engineer, in accordance with approved plans, but construction until completed to be under sole supervision and control of Western-Knapp; adequate water supply to be furnished by the Owner at its expense. Construction and installation, complete in every detail as per specifications, shall be turned over to Owner within five (5) months after date of agreement, completion to be evidenced by certificate issued by the Engineer and delivered to Western-Knapp on day of completion. Price is fixed at \$475,000, to be paid in cash sums equal to \$1.50 per ton for all ores or concentrates milled in the plant until 150,000 tons have been milled, and thereafter at \$1.00 for each ton milled, and as much additional in cash as Owner will then be able to pay, payments to be monthly, commencing on the 15th of the month next following date of completion and acceptance of the plant by Owner, until all obligations of the Owner are paid; operation of the property and plant during indebtedness to be under direct personal management of a managing operator to be employed by Owner but selected by Western-Knapp, and to remain in charge so long as employment approved by Western-Knapp, to whom the Owner will pay at least \$500.00 per month salary. Until all obligations of Owner were met, Owner agrees that all ore from its own mining claims will be milled at the plant, and payments will be measured on all tonnage milled at the plant, whether ores or concentrates there milled come from the premises of the Owner or of other persons; and "until such full payment of said Owner's obligations to Contractor, Owner will, from and after the date possession of said plant is turned over to Owner, continuously and without interruption, mine said properties, and will operate said plant to the maximum possible operating capacity of said plant"; and until full payment Western-Knapp shall have access to the mill, office records and accounts to verify the tonnage milled "after the completion and said acceptance of said plant and equipment as hereinabove provided." Seller warrants that material, equipment and work shall be according to Standard Engineering practice, free from defects that

may appear within sixty (60) days after the plant is completed and turned over to Owner for operation. After the 60 days period, should Contractor be able to make claim against any sub-contractor or materialman, he will without expense or liability to it and at Owner's request make such claim on behalf of Owner. Contractor will promptly pay all its bills and keep Owner's property and improvements free of liens, other than the Contractor's lien for any unpaid balance of the contract price, i.e., the \$475,000.00. Owner warrants that it will continue to maintain clear and merchantable title to its properties and furnish satisfactory evidence thereof, until payment in full. Owner agrees that its Engineer will inspect work and progress, at least once during each fifteen days during construction, and notify Western-Knapp in writing of any defect, which the latter agrees promptly to remedy. Final inspection will be made upon completion, and if the work has been completed to Engineer's satisfaction, he will issue a certificate of completion at that time to Contractor. Following the conclusion of a sixty (60) day operating test, the Engineer will make a further inspection, and if he finds any of Contractor's warranties not complied with, he will notify Contractor in writing, specifying the things remaining to be done or defects to be remedied in order to comply with warranties, and Contractor shall forthwith comply with the specification as a part of its obligation. Extra work shall not affect the right to a certificate on completion of the main contract, and the amount of extra work shall be added and become part of the purchase price under Exhibits M and N "and the payment thereof * * * shall be secured to Contractor by the terms and conditions of this Agreement and of said Contract of Conditional Sale." Eliminations shall be credited to the Owner on the last installments. Performance by either party is subject to delays without fault, from acts of God, fire, strikes, etc., or causes wholly beyond control. During construction the Contractor will insure against loss by fire, carry compensation insurance for its employees, and indemnify the Owner against liability for Contractor's acts. "After said work has been completed and turned over

to Owner for said sixty (60) day operating test, responsibility for losses by public liability shall devolve upon Owner" (R.15). The Contractor until payment in full will continue to carry and pay for fire insurance equivalent to full insurable value and not less than one-third of the outstanding and unpaid balance owing to Contractor, and proceeds of any fire policy will be applied to replacements of property destroyed "if such fire takes place prior to or subsequent to completion and acceptance of plant by Owner" (R. 15). Western-Knapp agrees to pay 1942 personal property taxes levied by the county against work in progress or completed. In the event Owner shall default under either Exhibit M or N for a period of ninety (90) days after notice specifying the nature of default, then Contractor may take possession of properties and mining claims of Owner and have exclusive management and control thereof "as additional security for the performance by Owner of the terms and conditions of this Agreement and of the aforesaid Contract of Conditional Sale" (R. 16); and if by operation of the Owner's properties, the Seller obtains sums sufficient to fully discharge the Owner's obligations under M and N, then any surplus becomes the Owner's property "and the Contractor shall forthwith re-deliver to Owner the aforesaid properties" (R. 16). Assignment and notices are provided for, along with changes of addresses for notices. The final paragraph (R. 17) is headed "Condition" and makes the obligation of Western-Knapp dependent on its own favorable acceptance "after the results of impending further prospecting of the property of Owner is completed; and, for all purposes, the effective date of this Agreements shall be the date when, and if, within forty-five days from date hereof, the undersigned Contractor shall notify Owner that said prospecting has been completed and that the results thereof are satisfactory to Contractor and that Contractor thereby elects to make the foregoing Supplemental Agreement and said Contract of Conditional Sale effective; and, upon completion of such prospecting, if the results thereof are considered unsatisfactory by Contractor, notice to that effect shall be given to Owner within forty-five days from

date hereof, and said Supplemental Agreement and Contract of Conditional Sale shall thenceforth, for all purposes, be deemed mutually cancelled and annulled" (R. 17).

It is evident that Western-Knapp's prospecting of the mining properties and claims of the Owner was completed and the result satisfactory, and the taxpayer accepted delivery of the plant and found it satisfactory after "the sixty (60) day operating test" (R. 15), because it proceeded to make substantial payments totaling \$364,127.22 in the years 1942, 1943, 1944 and to July 31, 1945. On December 10, 1942, a modification was agreed upon due to restrictions imposed by the War Production Board (R. 21-2), but payments continued on the modified basis (R. 20).

As said above, the taxpayer computed its "borrowed invested capital" under Section 719 (b) as \$221,476.59, considering that its written agreement with Western-Knapp qualified as one of the instruments evidencing indebtedness enumerated in Section 719 (a) (1), but the respondent disagrees.

SPECIFICATION OF ERRORS.

The United States Circuit Court of Appeals, Tenth Circuit, erred:

1. In holding that the written agreement between the taxpayer and the machinery house, evidenced by Exhibits M and N (R. 4-17), is not in legal effect a bond, note, debenture or certificate of indebtedness.
2. In holding that said agreement did not constitute a mortgage or deed of trust.
3. In construing the agreement between Seller and Buyer by labels and forms rather than by its legal effect and contents.
4. In discriminating, for all practical purposes, in favor of loans made by banks and other professional money-

lenders, and against loans made on security by machinery houses for productive purposes in mining and industry, evidenced in substantial compliance with Section 719 (a) (1), I.R.C.

ARGUMENT.

I. THE CONTRACT IN SUBSTANCE A NOTE, BOND, DEBENTURE, OR CERTIFICATE OF INDEBTEDNESS.

The captions and forms of Exhibits M and N are to be disregarded and the proper inquiry relates to their substance and effect. The essential qualities of the agreement clearly meet the qualifications of (1) a note, bond, debenture, or certificate of indebtedness, and (2) a mortgage or deed of trust. If it is in effect in either or any of these categories, then under the statute the \$221,476.59 was "borrowed invested capital", and the taxpayer's contention is correct. Section 719.

Dictionary definitions show the wide scope and variety intended by these terms. *Webster's New International* defines a note as:

"16. A written or printed paper acknowledging a debt and promising payment; a written promise to pay; as, a promissory note; a note of hand; a negotiable note; a bank note (note being often used alone for any of these phrases). * * *"

Webster defines a debenture as:

"c. Any of various instruments issued, esp. by corporations, as evidence of debt. Such instruments (often called debenture bonds) are generally, though not necessarily, under seal, and are secured by a mortgage or other charge upon property; * * *".

In giving various definitions of a bond, Webster says:

"Such an instrument made by a * * * corporation, esp. when a date is set for the payment of the prin-

cipal. * * * The bonds issued by corporations * * * are usually secured by a lien or mortgage upon property. * * * There are many forms or kinds of bonds, many of which are sufficiently described by their names, as * * * equipment bonds, etc."

Webster does not define a "certificate of indebtedness", but he defines a certificate generally, and says:

"2. A certified statement; a written testimony to the truth of any fact; hence anything that produces the same result as such a document; a certification; * * *"

Therefore, any duly executed writing, certifying the existence, amount and terms of payment of an indebtedness, and identifying the creditor or payee, would be a "certificate of indebtedness", regardless of form.

Manifestly, the use of all these general terms in a series shows the intention to disregard titles and forms and to consider only the substance and effect of a particular instrument. *Aetna Oil Co. v. Glenn, Collector, infra.*

We direct attention to the third and fourth unnumbered paragraphs near the beginning of the "Contract of Conditional Sale" (R. 4-5), also to paragraph numbered 4 of the "Supplemental Agreement on Conditional Sale" (R. 11-12). These paragraphs contain the terms of payment and all necessary requirements of a note, bond, debenture or certificate of indebtedness.

A note, bond or debenture need not be in any particular form if it has the essential elements, which are a written unconditional promise to pay to another a certain sum of money at a fixed or determinable future time. The agreement of petitioner contains those elements. A similar contract has been held to constitute "a note" under a federal revenue statute of identical wording as to the type of instruments.

Aetna Oil Co. v. Glenn, 53 Fed. Supp. 961.

The inclusion of further provisions besides the promise to pay is immaterial, yet many of the clauses at bar are characteristic of a long-form promissory note.

The agreement provides:

"In consideration thereof * * * Buyer agrees to pay to seller the total sums at the time and in the manner specified * * *". Exhibit M (R. 4-5).

"Buyer hereby agrees to pay forthwith any balance thereafter remaining unpaid therefor", i.e., after foreclosure sale. Exhibit M, at end of par. 4 (R. 7).

* * * Owner agrees to pay to Contractor the total sum of Four Hundred Seventy-Five Thousand Dollars (\$475,000.00) * * * in the following manner viz: * * * until the total purchase price above specified shall have been paid * * *." Exhibit N, par. 4 (R. 11-12).

In the last part of paragraph 4 of Exhibit N (R. 12), it is provided that "payment shall be measured upon all tonnage milled in said plant", and that "until such full payment of said Owner's obligations to Contractor, Owner will, from and after the date possession of said plant is turned over to Owner" (i.e., after the contract ceased to be executory or bilateral) "continuously and without interruption, mine said property and will operate said plant to the maximum possible operating capacity * * *". Owner agreed to pay "at all times, as much additional in cash as Owner will then be able to pay to Contractor" (Exhibit N, par. 4), and finally to pay "any balance thereafter remaining unpaid", i.e., after a foreclosure sale.

This covenant disposes completely of an assertion for the respondent that the agreement was not absolute but only contingent or conditional and that the obligations are "qualified or limited with respect to source of pay-

ment"; because if the ore obtainable from the owner's property, or from other properties for custom-milling by the owner, should fall short of "the maximum possible operating capacity of said plant", or if the owner allowed capacity-operations to lapse for any reason, then the owner would be in default, the entire balance would become due, the right of foreclosure and sale would accrue, and the owner would be liable for any deficiency (Exhibit M, par. 4, R. 7; Exhibit N, par. 4, R. 11-12).

The statement in the opinion below (R. 45) that the taxpayer's obligation was "contingent upon the amount of ore milled at the plant" is erroneous, because, although the payments were to be so "measured" (R. 12), there was no contingency permitted, no condition allowed or recognized; the owner must "continuously and without interruption *** operate said plant to the maximum possible operating capacity of said plant" (R. 12), namely, three hundred (300) tons daily minimum capacity (R. 9). Before the contract took effect at all, the seller was to completely prospect the taxpayer's property (R. 17), hence no contingency upon the ore supply therefrom was intended. But the agreement went farther, and demanded ores and concentrates from other properties if needed (R. 12), and the mill must run at maximum possible capacity (R. 12), regardless of volume or value of ores, or there would be a default (R. 7, 11, 12). There was no escape, but the absolute duty to see that maximum tonnage was milled. No matter how academic and far-fetched the possibility of a failure of an ore-supply might seem, it was still to be no excuse for failing in capacity operation and payment.

An examination of the instruments in their entirety will show the creation of an absolute indebtedness without any contingency whereby it need not be paid, and without any condition or option in Owner's favor to abandon or discontinue performance of its agreement and escape payment of the debt. The contract ceased to be executory in any bilateral sense as soon as the mill was completed and accepted by the Owner (Exhibit N, par. 3 and 4, R. 11),

and thenceforth the sole remaining obligation devolved upon the petitioner, who was correctly termed "the Owner" in Exhibit N, and whose obligation was correctly called its "indebtedness" (Exhibit M, par. 4, R. 6).

There can be no question but that this was a *bona fide* indebtedness. Up to July 31, 1945, payments totaled \$364,127.22, as follows: \$129,384.00 during the year ended November 30, 1942; \$73,427.01 during the year ended November 30, 1943; \$108,258.91 during the year ended November 30, 1944; and \$53,057.30 during the period from November 30, 1944 to July 31, 1945 (Stipulation, par. 9, R. 20).

Here, then, is a contractual writing whereby the buyer promised to pay the full purchase price and to pay any deficiency after foreclosure sale.

As said in *Aetna Oil Co. v. Glenn, Collector, supra*, 53 Fed. Supp. 961, a taxpayer is entitled to the credit "where the indebtedness was an actual *bona fide* one"; and the intention of the statute is to authorize credit "for an amount used to pay indebtedness evidenced by any bond, note, etc., indicating that no particular type of written instrument is required, so long as the indebtedness is actually evidenced by a written instrument of some type containing elements of an unconditional promise to pay." The court holds that the section must be given "a liberal construction so as to include such transactions as contain the necessary elements, regardless of the technical form."

On page 966, the Court says:

"The defendant contends that the written instrument is a contract rather than a note. This is merely a use of words rather than a real distinction. The instrument is a contract, but every negotiable note and non-negotiable note must be a contract before it can qualify as a note; it must contain the essential

elements of a contract, namely, an agreement voluntarily entered into between competent parties upon legal consideration on a legal subject matter. In order to constitute a note, the contract must also be in writing signed by the maker and call for the payment of money at a definite time rather than the delivery of goods or the performance of services. It is also distinguished from the usual type of bilateral executory contract in that it is executory on one side only, with the entire consideration having been passed and executed by the party who is entitled to call for the performance. Such is the exact type of contract that exists in the present case. Defendant's contention might be well taken if we should confine ourselves exclusively to the question of terminology. The statute refers to a 'note', which in the ordinary mercantile meaning is a short written instrument containing a promise to pay a certain person a certain sum of money at a certain time in the future, without introductory paragraphs and additional collateral agreements. But the statute must be construed according to its purpose and with a consideration of the circumstances existing at the time of its enactment. The purpose of this section of the statute was to limit the credit provided to cases where the indebtedness was an actual *bona fide* one, resulting from actual transactions in the past as reflected by the books and records of the corporation contemporaneously made. The use in the statute of the several words, 'bond, note, debenture, certificate of indebtedness, mortgage or deed of trust' indicates that no particular type of a written instrument was required so long as the indebtedness was actually evidenced by a written instrument of some type containing the elements of an unconditional promise to pay."

By the terms employed in Section 719 (a) (1), it is evident Congress did not intend technical narrowness in construing the words in the series. Negotiability was not prescribed for the note, nor did the lawmaking power con-

cern itself with a limited sense for any of the instruments mentioned. The statement by the court just quoted, that "the Act must be given a liberal construction", was very recently confirmed in the unanimous opinion of the Circuit Court of Appeals for the Second Circuit in *Brewster Shirt Company v. Commissioner of Internal Revenue*, 159 Fed. (2d) 227, where the court said of the present Section 719 (a) (1), speaking at pages 228 and 229:

"The Commissioner gave a narrow construction to the words 'bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage or deed of trust' and assessed a deficiency in excess profits taxes by holding that the taxpayer was not entitled to the credit claimed under Sections 712 and 714 * * *. * * * We think that the decision interprets the credit allowable under Section 719 for borrowed invested capital too narrowly and was not required by the prior authorities on which it relied."

(The facts and opinion in the *Brewster* case are given at more length later in this brief.)

Under the liberal construction intended, we therefore submit that the agreement at bar amounted in effect to a note, bond, debenture, or certificate of indebtedness.

II. THE AGREEMENT A MORTGAGE OR TRUST DEED..

Exhibits M and N are so clearly a security arrangement that if the parties had captioned them as mortgages or as sale and security agreements the Commissioner would probably never have disallowed the credit requested. But having been labeled "Contract of Conditional Sale" and "Supplemental Agreement on Conditional Sale", their essential quality and effect are disputed.

While retaining the legal title in the seller Western-Knapp, Exhibits M and N pass possession, enjoyment

and the equitable title to the buyer Consolidated, the equity of the latter increasing with every payment made on the purchase. The buyer agrees to keep the plant and mill and the real estate where they are built free and clear of any other liens or encumbrances. Exhibit N, par. 5 (c), R. 13. They make the buyer liable for the full purchase price (Exhibit M, R. 4-5, 6-7, and Exhibit N, par. 4, R. 11), the buyer being expressly made liable for any deficiency (Exhibit M, par. 4, R. 7) after seller's right of sale has been exercised.

The legal soundness of the petitioner's contention is shown by the unanimous decision of January 11, 1947, by the Circuit Court of Appeals, Second Circuit, construing Section 719 (a) (1) and reversing the Tax Court. In *Brewster Shirt Corporation v. Commissioner of Internal Revenue*, *supra*, 159 Fed. (2d) 227, the taxpayer had entered into a factoring arrangement expressed in a general writing, under which separate instruments were made from time to time assigning the taxpayer's accounts to a credit or lending corporation, which advanced funds to the taxpayer on the security of these assignments and the general written agreement. The Commissioner had disallowed any credit by reason of sums borrowed by the taxpayer under this agreement and shown in its return to establish a proper credit, in reporting its excess profits net income for 1941; and the Tax Court had sustained the Commissioner. After, saying that both the Commissioner and the Tax Court had given a "narrow construction" and had viewed the credit allowable under Section 719 "too narrowly", Circuit Judge Augustus N. Hand, speaking for the unanimous Court, says, at pages 229-230:

"It is clear that as soon as accounts were assigned and advances made thereon the agreement and assignments involved security transactions which in law constituted a mortgage. What legally is a mortgage is a matter of substance and not of mere form. This has long been the settled New York doctrine as is shown in the decisions in *Shelton v. McFee*, 216 N. Y. 618, 620, 111 N. E. 220; *Dunham v. Whitehead*, 21 N. Y. 131, 133; *Leitch v. Hollister*, 4 N. Y. 211, 216;

cf. *In re Bernard & Katz, Inc.*, 2 Cir., 38 F. 2d 40. While the meaning of the term 'mortgage' in a tax statute like the one under consideration is ordinarily a matter for controlling determination by the United States Courts, decisions of the State Courts which define a commercial term in such common use as 'mortgage' are a reasonable source of guidance.

"The effect of the interpretation given by the Tax Court to the term 'mortgage' would be to subject Factoring Agreements to burdensome excess profits taxes * * * We cannot suppose that it was the intention of Congress to subject security given under Factoring Agreements to a form of taxation which would in effect discriminate against those arrangements in favor of secured bank loans, especially when borrowers from Factors are a class frequently least able to bear the burden. The fact that the security was given in the form of outright assignments is quite unimportant when the transaction was in effect a mortgage. Indeed, Article 'Fourth' of the agreement with Mills Factors Corporation assigns all accounts 'as collateral security.' Articles 'Ninth' and 'Fourteenth' moreover show that the accounts are collateral for loans and that the borrower is liable for any deficiency. We hold that the indebtedness here was evidenced by instruments which constituted a mortgage. It made no difference that Article 'First' of the agreement provided that the Factor should 'purchase said accounts subject to the terms and conditions hereinafter set forth, at their net face value, less trade discounts and commissions', for the advances were in fact loans, the assigned accounts were collateral security by the terms of the agreement, and repayment of the advances was guaranteed by the borrower. *Home Bond Co. v. McChesney*, 239 U.S. 568, 36 S. Ct. 170, 60 L. Ed. 444."

The Brewster decision is directly in point, and the very words of the agreement are strikingly alike, e.g., as to liability for any deficiency, etc.

If it be suggested that there is a distinction because at bar the "legal title" was "retained" by Western-Knapp, whereas by the *Brewster* agreement the "legal title" to the accounts was "transferred" from debtor to creditor instead of having been "retained" by the latter, this is a barren distinction, as shown and held many years ago by this Court in *Chicago Ry. Equipment Company v. Merchants National Bank*, 136 U.S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 252-253, *supra* where in 1889 Mr. Justice Harlan delivering the unanimous opinion, said:

"The defendant insists that, in view of the agreement for the retention by the payee of the title to the cars until all the notes of the same series, principal and interest, are fully paid, the transaction was only a conditional sale of the cars. It is contended that the promise to pay the notes given for the price, so far from being absolute as required by the mercantile law, is subject to the condition, running with the notes, that the title to the cars should not pass until all the notes were paid, which could not occur if, before payment, the cars had been destroyed or sold to other parties. The fact that, by agreement, the title is to remain in the vendor of personal property until the notes for the price are paid, does not necessarily import that the transaction was a conditional sale. Each case must depend upon its special circumstances. In *Heryford v. Davis*, 102 U.S. 235, 243, 244, 245, 246 (25:160, 162, 163), the question was whether a certain instrument, relating to cars supplied to a railway company, and for the price of which the latter gave its notes, showed a conditional sale, which did not pass the ownership until the conditions were performed, or whether, taking the whole instrument together, the seller reserved only a lien or security for the payment of the price, or what is sometimes called a *mortgage back* to the vendor. In that case, the instrument construed provided that until a certain payment was made, the railway company should have no right, title, claim nor interest in the cars delivered to it,

'except as to their use or hire,' nor any right or authority in any way to dispose of, hire, sell, mortgage or pledge the same, but that they 'are and shall remain the property' of the manufacturing company, and be redelivered to it when demanded, upon default in the above payment. This court, after observing that the true construction of the contract was not to be found in any name which the parties may have given to the instrument, nor alone in any particular provisions it contained, disconnected from all others, but in the ruling intention of the parties, gathered from all the language used, said: 'It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account. Though the contract industriously and repeatedly spoke of loaning the cars to the railroad company, for hire for four months, and delivering them for use for hire it is manifest that no mere bailment for hire was intended. No price for the hire was mentioned or alluded to, and in every bailment or letting for hire a price or compensation for the hire is essential. * * * It is quite unmeaning for parties to a contract to say it shall not amount to a sale, when it contains every element of a sale, and transmission of ownership. This part of the contract is to be construed in connection with the other provisions, so that if possible, or so far as is possible, they may all harmonize. Thus construed, it is quite plain these stipulations were inserted to enable the manufacturing company to enforce payment, not of any rent or hire, but of the selling price of the cars for which the company took the notes of the railroad company. They were intended as additional security for the payment of the debt the latter company assumed. This is shown most clearly by the other provisions of the contract. * * * No part of the money was to be returned to the railroad company in any event, not even if the cars should be returned. * * * What was this but treating the notes given for the sum agreed to be the price of the cars as a debt absolutely due to the vendors? What was it but treating the cars as a security for the debt? * * * In view of these provisions, we can come to no other conclusion

than that it was the intention of the parties manifested by the agreement that the ownership of the cars should pass at once to the railroad company in consideration of their becoming debtors for the price. Notwithstanding the efforts to cover up the real nature of the contract, its substance was an hypothecation to the vendors for the price of a sale. The railroad company was not accorded an option to buy or not. They were bound to pay the price, either by paying their notes or surrendering the property to be sold in order to make payment. This was in no sense a conditional sale. This giving property as security for the payment of a debt is the very essence of a mortgage, which has no existence in a case of conditional sale.' * * *

" * * * This provision placed the parties upon the same footing they would have occupied if a chattel mortgage covering all the notes, had been executed by the purchaser of the cars. * * *

"The agreement that the title should remain in the payee until the notes were paid—it being expressly stated that they were given for the price of the cars sold by the payee to the maker, and were secured equally and ratably on the property—is a short form of chattel mortgage. The transaction is, in legal effect, what it would have been if the maker, who purchased the cars, had given a mortgage back to the payee, securing the notes on the property until they were all fully paid."

This opinion has never been overruled, modified, or questioned (Shepard's U. S. Citations).

So here, the arrangement was one of security for Western-Knapp. The contract expressly and repeatedly says it is for "security" (Exhibit N, second paragraph of 7, R. 14; all of 13, R. 16; see also 5 (c), (R. 13). Provision after provision, as for repossession, operation by mortgagee, payment of taxes, sale, and liability for any defi-

ciency, are all characteristic of a security and mortgage arrangement as found in corporate mortgages and not of a bare condition or naked option lacking any vested equity and property right in the obligor.

The clause whereby the mill is operated under a supervisor representing Western-Knapp (R. 12) and in case of default (which includes failure to operate at capacity for any reason) Western-Knapp can take over possession (R. 6-7), is a familiar paragraph in corporate mortgages on many kinds of property that require operation and management, as for example railroad rolling stock, hotels, apartment houses, manufacturing plants, ranches and farms, and all types of factories and mills; all going to show the intention to create the fullest possible security for payment of the purchase price and pledging the general credit and resources of the taxpayer to payment in full of any deficiency, and not merely production, which is only used as a measuring rod by which the amount and time of payment of installments were to be "measured" (Exhibit N, on R. 12).

Paragraph 13 of Exhibit N (R. 16) gives the mortgagee the right, on default, "to the exclusive management and control of said properties * * * as additional security for the performance by the owner of the terms and conditions of this Agreement and of the aforesaid Contract of Conditional Sale"; and if the mortgagee shall by such operation "obtain sums sufficient to discharge in full the obligations of Owner hereunder," any surplus from such operation shall go to the owner along with re-possession. In short, paragraph 13 (R. 16) provides additional security for full payment of the \$475.000.00 in case of any default by the owner-mortgagor, and since full capacity-operation of the mill, regardless of any contingency, is necessary to prevent a default, there is nothing conditional whatever about the obligation to pay. This would be true even if the sufficiency of ore both in the mine and in the whole surrounding region could be open to question. In reality, this would be an unreasonable

and academic question to raise, because, by paragraph 16 (R. 17), Western-Knapp was not to proceed with the construction at all until after it had made an expert survey of the ores in the mine and had satisfied itself that the ores were in ample quantity; and the existence of many other mines producing ores in the surrounding region of Nevada and Utah, to be drawn upon for custom-milling to supplement ores from the owner's mine if need be, is common knowledge of which the court will take judicial notice.

However, if we disregard paragraph 16 (R. 17) and the expert finding by Western-Knapp of enough ore to operate the mill at full capacity for payment in full, and if we further assume that the supply of custom-ore obtainable in that region may be insufficient to supplement ores from the mine, still the taxpayer undertook and assumed the absolute obligation none the less to operate the mill at full capacity (R. 12), failing which operation for any reason there would be a default in performance and an absolute liability to pay the balance and deficiency.

Nowhere is any contingency recognized which will relieve the owner from paying this indebtedness.

As said by the Court in *Cary & Co. v. Hyer*, 91 Fla. 322, 107 So. 684, at page 687:

"The purpose and intention is therefore to be ascertained, not alone from the form of the instrument which evidences the transaction, but principally from the conduct of the parties and a fair consideration of the entire transaction as disclosed by the underlying facts and circumstances. An important if not a controlling guide in determining the intention of the parties is the purpose sought to be accomplished by them. Purpose is usually an unerring indication of intention * * * An attempted agreement between the parties that an instrument shall not operate as a mortgage, but as an absolute conveyance, when wholly inconsistent with the surrounding facts

and attendant circumstances, does not make absolute a conveyance given 'for the purpose or with the intention of securing the payment of money', whatever may be the form of the conveyance, and the mere absence of defeasance does not alone determine the matter.

"*Pitmann vs. Milton*, 68 So. 658, 69 Fla. 304; *Connor v. Conner*, 52 So. 727, 59 Fla. 467; *Willy-Gabbett Co. v. Williams*, 42 So. 910, 53 Fla. 872; *Hull v. Burr*, 50 So. 754, 58 Fla. 432.

"If, in view of all the circumstances, the transaction resolves itself into security for the payment of money, it is a mortgage. *Elliot v. Conner*, 58 So. 241, 63 Fla. 408; 11 C. J. 406."

Here the surrounding circumstances, the phraseology, and the conduct of the parties all indicate conclusively that the parties intended to effect a sale to "the Owner" and a mortgage back to the seller. Acceptance and possession of the mill by the Owner were definite and complete, and its operations and payments were large and substantial. Later, when abnormal war conditions involving government restrictions arose, the familiar action between mortgagor and mortgagee followed. They met, conferred over the situation, and made the memorandum of December 10, 1942, to tide the debtor and mortgagor over the emergency by a temporary modification of terms (R. 21-22). It would be hard to imagine of surrounding circumstances and a course of conduct more characteristic of the debtor-creditor and mortgagor-mortgagee transaction and relationship than the present.

That a conditional sale amounts to a mortgage is recognized under Nevada law and is a well-settled principle throughout the country in both the federal and state courts.

In *Nevada Motor Co. v. Bream*, 51 Nev. 89, 269 Pac. 602, the Supreme Court of Nevada says, at page 604:

"The vendee, under a contract of conditional sale, is the equitable owner of the article specified in the contract. The person in possession of an automobile under a contract of conditional sale is for all practical purposes the owner thereof. *Welch v. Harnett*, 127 Mis. Rep. 231, 215 N. Y. S. 540."

And on page 605:

"This case is followed in a number of cases. In *Atkinson v. Japink*, 186 Mich. 338, 152 N. W. 1080, it is held that, where an automobile is sold for cash and two notes, reserving title to car until notes were paid, title is retained as security only."

"In *Williston on Sales*, Sec. 330, it is said:

"As the purpose of the seller's rights, whether a legal title, or whether a right to resume the title on breach of condition, is merely to give him security for payment of the price, the transaction is in its essence a mortgage, though futile distinctions are often made."

"That this is true has been frequently recognized. See note 80, *Williston on Sales*, Sec. 330."

Here also the instruments set up a security relation where legal title was reserved in the seller as security; equitable title and possession passed to the buyer, subject to being divested by foreclosure upon default, and liability for any deficiency after foreclosure sale was expressly created. The terms "mortgage" and "deed of trust" in section 719 (a) (1) were not intended in the narrow sense of a stationer's form, or as necessarily importing a form of absolute conveyance to the mortgagee subject to a defeasance upon making full payment, this original meaning being an outmoded fiction everywhere, since the conveyance is not absolute, whatever its language, but is creative only of a lien for security, with all the well-known equitable effects, remedies and safe-guards for both parties, often in flat contradiction to the literal

terms of the mortgage instrument. Common forms of mortgages still "bargain, sell and convey," like a deed, although everyone knows that a simple lien is created and intended. The same considerations apply to the phrase "deed of trust," whatever the form or the interposition of a third person as trustee. The mortgagee or holder of legal title (Western-Knapp) was essentially a trustee for the equitable interests, not only of itself, but also of Consolidated, which latter steadily grew as the payments mounted, while Western-Knapp's co-ordinately dwindled, until its title became a completely naked legal title or naked trust when the last dollar was paid. Upon full payment, the seller's trusteeship ceased to be any longer coupled with an interest. Nothing remained but for it to execute a bill of sale (Exhibit M, par. 2, R. 6).

It is an established principle that, where a vendee has paid a substantial amount on the price, he has acquired an equity in the property which cannot be torn away by the process of forfeiture, regardless of the terms of the instrument of sale, and of whether it is called a mortgage or a conditional sale, lease, option, or something else. The vendor is relegated to the remedy of foreclosure, and the instrument is held to be a mortgage. This is well settled throughout the country and has recently been reaffirmed in two well considered cases:

Rocky Mountain Gold Mines Inc. v. Gold Silver and Tungsten, Inc., 104 Colo. 478, 93 Pac. 2d 973.

Fairview Mining Company v. American M. & S. Co., 86 Colo. 77, 278 Pac. 800.

In *Rocky Mountain Gold Mines Inc. v. Gold, Silver and Tungsten Inc.*, *supra*, the court held:

"Equity has to do with the substance and reality of a transaction—not the form and appearance which it may be made to assume. In construing a contract concerning mining property and involving a lease and option thereon, it is the intention of the parties there-

to that concerns equity. If the true nature is that of security, the transaction will be given that effect regardless of how many papers have been executed to cover up its purpose and give it an appearance other than the true one. If a transaction resolves itself into a security, whatever may be its form and whatever name the parties may choose to give it, it is in effect a mortgage.

"Where a vendee, under a contract of sale and purchase has substantially performed, the contract involved operates simply as an instrument of security as to the balance to be paid; there is breathed into what may be termed the severe legal language of the contract an equity superior to its terms."

In *Fairview Mining Company v. American M. & S. Co.*, *supra*, the court said:

"Where the grantor in a contract for the sale of property retained title thereto as security for payment of the agreed purchase price, the relation between him and the grantee was the same as if title had passed from grantor to grantee, and the latter had conveyed the title back to the grantor as security for such payment."

As said in *Hoar* on "Conditional Sales" at page 5:

"*What is retained?*—Conditional sales contracts themselves, and courts and legislatures in discussing them, almost always speak of the retention of title or property in the goods by the seller, until the purchaser fulfills the condition; but this is a mere legal fiction, for it is clear that the purchaser possesses all the incidents of title, except the power to pass title to a third party. The seller is not interested in title; what he is interested in is security for the performance of the conditions, and all that he really regards himself as retaining is a lien to secure this performance.

"Some states frankly recognize this fact by treating conditional sales for what, in substance, they really are: namely, a sale with mortgage back to secure the purchase price."

Nevada is such a state.

Nevada Motor Co. v. Bream, 51 Nev. 89, 269 Pac. 602, 604, *supra*.

So is Colorado and all other Western States so far as we know.

On page 19, Hoar says, speaking of Colorado:

"Conditional sales are held by court decision to be chattel mortgages unless payment is optional."

That this has also been the rule of this Court since 1889 to the present day is shown by *Chicago Railway Equipment Co. v. Merchants National Bank*, *supra*.

To this effect are very numerous other federal cases, among which are the following:

In re Central States Freight Corporation, 46 Fed. (2d) 545 (Mich. 1931), the court said on page 546:

"The petitioner claims that each of these contracts is one of pure conditional sale, and that it still owns, and is entitled to reclaim, said trucks, while the trustee in bankruptcy contends that each of such contracts was one of absolute sale with reservation of title in the vendor merely as security for payment of the purchase price, and therefore, in effect a chattel mortgage, which was required, by a Michigan statute applicable to chattel mortgages, to be filed for public record, and, not having been so filed, is void as against the creditors of such vendor. The referee sustained this contention of the trustee and denied the reclamation petition, which ruling the petitioner now seeks to review in this court."

The court then quotes lengthy provisions of the contract including:

"It is further agreed that the title to said property shall remain in said vendor until the whole purchase price thereof shall be fully paid, but when said purchase price has been fully paid shall vest in the vendee.

"It is further agreed that in the event of failure by the vendee to pay said purchase price or any part thereof as above provided, * * the whole of said sum shall immediately become due and the vendor may take possession of said property with or without legal process. * * *

(In the present case, this court will not overlook the substantially identical provisions in Exhibit M, par. 4, R.7, which provides that upon any failure to pay or other default under the contract "the full amount unpaid of all indebtedness hereunder shall become due and payable," etc.).

The court continues on page 574:

"* * * If the seller is not limited to the right to retake the property and retain the payments made, but after reclamation may enforce payment of the remainder of the full and agreed price, and the instrument is so worded as to permit this to be done, then the courts will recognize the instrument for what it is in fact and law, security in the nature of a chattel mortgage. * * .

"The order of the referee complained of was correct and is affirmed."

In *Weber Showcase, etc., Co. v. Waugh*, 42 Fed. (2d) 515 (D.C. Wash. 1930), the court says on page 520:

"It can also be said that a conditional sales contract authorizing the seller to retake and sell the property on default and recover any deficiency, under the Washington policy, is in fact a chattel mortgage,

* * * and, where doubt arises on the face of the instrument, courts usually treat it as a mortgage. *Low v. Colby*, 137 Wash. 476, 253 P. 18, 247 P. 475."

In *New York Security & Trust Co. v. Capital Ry. Co.* (Phoenix Iron Works, Intervener), 77 Fed. 529, the court said on page 531:

"This question should be determined by the Kentucky law, and by that law an agreement to retain the title of personal property sold until the payment of the purchase price, when the property is delivered, is, in effect, an absolute sale, with mortgage back. *Greer v. Church*, 13 Bush 430; *Balwin v. Crow*, 86 Ky. 679, 7 S. W. 146; *Lumber Co. v. Smith* (Ky.), 32 S. W. 167; *Hart v. Manufacturing Co.*, 7 Fed. 544."

In *Cooper v. Michigan Artificial Ice Products Co.* (1930; D. C.), 1 F. Supp. 741, affirmed in 1932, C.C.A. 6th, 61 F. (2) 1046, in which certiorari was denied in 1933, 288 U. S. 608, 77 L. Ed. 983, 53 S. Ct. 400, the federal court says:

"The second question is the familiar one of whether the contract under which the equipment and machinery in this case was sold should be construed as one of conditional sale or one whereby the seller reserved title by way of security merely to enable him to collect the purchase price. * * * It is the view of the court that the contracts here in question must be construed as creating a lien by chattel mortgage upon the property."

At bar, the obligation to pay was not optional in any sense, as the promise was absolute and after a foreclosure sale the taxpayer was bound to pay any deficiency.

The court below misconceived the taxpayer's obligation by saying it was conditional and bilateral, citing *Journal Publishing Co. v. Commissioner*, 3 T. C. 518. As seen, the agreement at bar was not conditional, and was not bilat-

eral after the plant had been tried and accepted by Consolidated (R. 11, 13). Nothing remained for the machinery house to do. Western-Knapp was like a money-lender who had delivered the money and accepted a note, the arrangement becoming unilateral as soon as the promisor received the money loaned. *The Journal Publishing Company* decision points the distinction clearly. The *Journal* case differs in its most significant feature from the case at bar, and by presenting the antithesis of the present contract, bears out the claim of the petitioner. In the *Journal* contract, out of the total \$520,000.00 consideration agreed upon as the price of a business, only \$50,000.00 was for tangible assets, and \$470,000.00 was for the seller's promise over a period of five (5) years to discontinue and not resume publication or otherwise compete. The Tax Court said in the *Journal* case:

"In the case of a promissory note, the antecedent obligation for which it is given is merged and no further duty is required of the promisee. In short, the undertaking in a promissory note is unilateral.
* * *

"In the recent case of *Aetna Oil Company v. Glenn*, 53 Fed. Supp. 961 (U.S.D.C., W.D. Ky., Feb. 14, 1944) 41-1 U.S.T.C., Sec. 9203), the court held that within the language of section 27 (a) (4) of the Revenue Act of 1938, as to dividends paid credit, the word 'note' in the expression 'bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust' means a 'written instrument of some type containing the elements of an unconditional promise to pay.' The promise to pay there involved was unilateral and absolute and with 'nothing further to be done by the payee in order to make the obligation a binding one,' whereas here the contract was bilateral and the payee had a continuing obligation, not to compete. The case only serves to emphasize that we do not have here a note within the statutory intent."

At bar, the agreement ceased to be bilateral, or executory as to both parties mutually, upon completion and acceptance of the mill five years ago (R. 11-15, Exhibit N, par. 3, 5, 6, 9). Nothing further remained for the payee Western-Knapp to perform; the contract became and was unilateral, absolute and executory on the part of the taxpayer only, after the delivery to and acceptance by it of the completed mill (R. 20, par. 9). The contract being executed by the payee, and remaining only as the unilateral obligation of the petitioner to complete its payments (R. 20), it presents the essential nature of a promissory note, bond, debenture or certificate of indebtedness, which characteristic was lacking in the *Journal* case and was there recognized by the court to exist in a situation like the present.

The lower court cites the Nevada cases of *Sellai v. Lemmon*, 62 Nev. 330, 151 Pac. (2d) 95, and *Studebaker Bros. Co. v. Witcher*, 44 Nev. 442, 195 Pac. 334, as somehow overruling *Nevada Motor Company v. Bream*, 51 Nev. 89, 262 Pac. 602, which cites and follows the decision of this Court in *Chicago Railway Equipment Company v. Merchants National Bank*, *supra*. The *Sellai* case is wholly inapplicable at bar. It in no way refers to the *Bream* case, and is not in conflict with it, and does not overrule it, both being recent pronouncements of the Nevada Supreme Court. The question whether the so-called conditional sale was in reality a mortgage, as stated and held in the *Bream* case, was not involved or discussed at all in the *Sellai* opinion, which raised the question of the right of the seller, on default of the buyer, to sue for a deficiency! The *Bream* opinion is the latest or final pronouncement on the subject in Nevada. It cites and follows *Atkinson v. Japink*, 186 Mich. 338, 152 N. W. 1080, a leading American case. It adopts the language of *Williston on Sales*, Sec. 330, that a transaction like the agreement at bar "is in its essence a mortgage, through futile distinctions are often made." The Nevada court quotes at length from the

Chicago Ry. Equip. Co. case, in showing that such contracts are mortgages.

Chicago Ry. Equip. Co. v. Merch. Nat. Bk., supra,
136 U. S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 352-3.

As stated above, no distinction whatever is made in the *Sellai* case between mortgages and conditional sales contracts, and the citation therein of *Studebaker Bros. Co. v. Witcher*, (1921), 44 Nev. 442, 195 Pac. 334, is only on the point of the first syllabus, discussed in the opinion on page 96, that a provision whereby the seller, on default by the buyer, may repossess the property, sell it, and bring suit for the deficiency, is not inconsistent with retention of title in the seller nor contrary to public policy. Since, therefore, the buyer's interest can be sold, he must have had an equitable ownership, the seller's remaining interest must have been by way of security, and the transaction has been in substance a mortgage, as later, in 1928, expressly held and stated in *Bream* case, which remains the settled law of Nevada. Not a word in the *Sellai* opinion intimates that such a contract is not in effect a mortgage or that the *Bream* opinion was wrong, nor was the mortgage relationship questioned. In the *Bream* opinion, the court impliedly but clearly overrules the older decision of *Studebaker Bros. v. Witcher* (1921), *supra*, 44 Nev. 442, 195 Pac. 334, insofar as the *Studebaker* case had lent color to the idea that such a sale was not in effect a mortgage, for, in the overruled *Studebaker* case the court had said:

"It is strongly urged that these provisions * * * clearly indicate a mortgage. Appellant's counsel contends that these provisions bring the contract within the rule announced in *Atkinson v. Japink*, 186 Mich. 335, 152 N. W. 1079, and recognized in *Young v. Philip*, 203 Mich. 566, 169 N. W. 822, as a test to distinguish an absolute sale with a mortgage back from a purely conditional sale. We must concede that the

Michigan cases just cited are authority for the construction claimed, but we find that the authority from other jurisdictions is against them in this respect."

But seven years later, in the *Bream* case (1928), the Nevada Supreme Court cites and follows that very leading case of *Atkinson v. Japink*, 186 Mich. 338, 152 N.W. 1080, and adopts the words of *Williston on Sales*, Section 330, as above quoted. Moreover, in *3 Jones on Chattel Mortgages and Conditional Sales*, Bower's Ed., Sec. 1263, that authority says:

"Perceiving the injustice that might flow from the strict enforcement of the rule denying to the conditional purchaser any property rights in the chattels prior to full payment, judicial views took a new slant * * * so that it has now come to be that the conditional purchaser is, for all practical purposes, the real owner, and that the seller holds a bare and inactive title as a guaranty that he will be paid the purchase price."

The author then cites *In re Bettman-Johnson Co.* (C.C.A. 6th), 250 Fed. 657, and decisions from Arkansas, California, Maine, Massachusetts, Minnesota, Nevada (*Nevada Motor Co. v. Bream*), New York, North Carolina, Oregon, and Tennessee, and continues:

"This change is undoubtedly a step forward in the awarding of justice. Moreover, it is a recognition of the principle, which is germane to the present discussion, that when a chattel is delivered to a purchaser under a conditional sale he acquires property rights in it which are substantial and which he may transfer. His interest in the property is more frequently defined in the later cases by saying that he is theitable owner of it."

The *Bream* case has become one of the leading American cases and has been cited and followed in:

Fruehauf Trailer Co. v. State Corp. Comm., 149 Kan. 465; 87 Pac. (2d) 641, 646;

E. J. Jones & Co. v. Unruh, 37 Del. 241; 182 Atl. 211, 212, 213;

Johnson v. Winn and Lovett Co., 126 Fla. 434; 171 So. 297, 298;

Truitt v. Patten, 75 Utah 567; 287 Pac. 175, 176.

In short, the *Bream* opinion in laying down the accepted and existing law of Nevada that such a contract "IS IN ESSENCE A MORTGAGE", quotes and follows expressly the Supreme Court of the United States in *Chicago Ry. Equipment Co. v. Merch. Bk.*, *supra*.

The payment secured by a conditional sales contract which is in essence a mortgage, is the unpaid balance of the price so that the purchaser must pay in full before he can obtain complete equitable and legal title to the property, and the seller retains his co-ordinate equity until the full balance is paid him. Both equity and law now look through form to substance in all cases. The instrument is a mortgage, since only by foreclosure, affording an equity and period of redemption, can the purchaser's accumulated equitable interest be divested upon failure to pay the balance. At bar, the taxpayer by the end of July, 1945 had paid between three-fourths and five-sixths of the purchase price (R. 20); and over the particular taxable period here in question, it was borrowing capital from Western-Knapp to the average extent of twice \$221,476.59 (R. 19-20, Stipulation, par. 6-8). For those unpaid balances Western-Knapp at all times had its vendor's or mortgage lien, the two being identical in substance. By July 31, 1945, the balance of indebtedness had been reduced to but little more than \$100,000.00 (R. 20, Stipulation, par. 9). The taxpayer owed the remainder of the purchase price to Western-Knapp as it would have owed a bank if it had borrowed the money from a bank in order to pay Western-Knapp in full, and had evidenced and secured the bank-loan on some printed forms of note and mortgage. It is borrowed capital in either case. As said by the Second Circuit in the *Brewster* case, *supra*:

"We cannot suppose that it was the intention of Congress to subject security given under" such an agreement "to a form of taxation which would in effect discriminate against those arrangements in favor of secured bank loans."

The indebtedness would still have been borrowed capital, even if the instrument securing the price had been a simple mortgage without the giving of a note, i.e., without creating an indebtedness upon which a personal judgment against the taxpayer could be obtained. There may be a mortgage without a note or personal obligation, the mortgagee thus looking entirely to the security, whence he may realize the debt or the balance of the purchase price for which credit was given, as the case may be, but without any right of deficiency or personal judgment.

41 C. J., page 653, Sec. 644, par. 1.

This somewhat rare type of contract would have been far short of the liability here created (R.7), but it emphasizes the intention of Section 719 (a) (1) that the balance is to be considered borrowed capital whether the instruments are to be construed as a note and mortgage, or as a note or mortgage.

Lake's Laundry, Inc. (C.C.A. 2d), 79 F. (2d) 326, mentioned in the opinion below, sustains, rather than contravenes, the petitioner's contention at bar. The case was a 77B proceeding in bankruptcy, where the laundry was the vendee of machinery and a truck, for which it had not paid, and the vendors were permitted to reclaim said property. There was no desire asserted by a trustee in bankruptcy to retain the property upon payment from the estate of the balance of the price, or his right to do so would have been recognized (*Bailey v. Baker Ice Machine Co.*, 239 U. S. 268, 270, 36 S. Ct. 50, 60 L. Ed. 275, 277). There is no question but that the legal title had been retained by the sellers, as it was by Western-Knapp at bar, "until payment in full" (R. 5). The *Lake's Laundry* case was decided in 1935 by the same court (C.C.A.

2d) which later sustained the position of the petitioner herein under Section 719 (a) (1) on January 11, 1947, in *Brewster Shirt Corporation v. Commissioner*, 159 F. (2d) 227. In *Lake's Laundry*, the majority of the court, while permitting the vendors to reclaim possession under the N. Y. act, P.P.L. Sec. 60-81, because of the vendee's defaults, nevertheless recognized the possible equities of the vendee, and closed their opinion by saying:

"We now leave open all questions as to final disposition of the proceeds of such equities in the property as the debtor may be found to have when it is repossessed and dealt with as the laws of New York provide."

The vendors were required to go through a foreclosure proceeding after reclaiming possession. The New York statute, which is the enactment effective September 1, 1923, of the "Uniform Conditional Sales Act," is Art. 4 in the Personal Property Law division of the Consolidated Laws of New York (Birdseye, Cummings & Gilbert's C.L. Ann., Vol. 13, 2d Ed. Cum. Supp. 1921-3, Vol. 2), and provides for retaking possession by the seller after due notice of intention, affording opportunity for payment (Secs. 76 and 77); redemption (Sec. 78); compulsory resale by seller (Sec. 79), and disposition of proceeds of resale (Sec. 80-b), and makes any prior waiver of the statutory protection and equity of the buyer invalid (Sec. 80-f). Filing for record is necessary to bind a creditor of or purchaser from the buyer (Secs. 65 and 66). The whole act is an eloquent illustration of the legal principle that the so-called conditional sale where title is retained as security is simply a mortgage and that the foreclosure and redemption rights are the same. The only difference between the majority and minority opinions in *Lake's Laundry* was procedural under Section 77B and related to possession. Circuit Judge Learned Hand dissented, because of his view of Section 77B, from the immediate disposition ordered, and used the following language:

"It seems to me a barren distinction, though indubitably true, that title does not pass upon a conditional sale; 'title' is a formal word for a purely conceptual notion; I do not know what it means and I question whether anybody does, except perhaps legal historians. The relations resulting from conditional sales are practically the same as those resulting from mortgages; I would treat them as the same when we are dealing with the reorganization of the debtor's property."

As seen, the majority order gave the sellers possession, subject to the buyer's equities, under the New York statute, and Judge Hand's dissent was on the ancillary feature whether the seller should be permitted to have possession, similar to the possession of a receiver (See the closing words of the majority, above quoted). In many cases, a mortgagee may be allowed possession upon default in order to make his security effective. This is expressly stipulated in practically all corporate mortgages, and was provided in the contract at bar (R. 16, Ex. N, par. 13), such provision thus further identifying the agreement as a mortgage. At bar no default is involved. In foreclosures, possession by the mortgagee, or a trustee, or receiver, may or may not be permitted by the court, depending upon the circumstances and equities in the particular case, and a court might well have denied possession to Western-Knapp despite paragraph 13 of Exhibit N, if Consolidated had somehow defaulted, depending upon the equities and particular facts; because paragraph 13 (R. 16) was clearly only an additional security provision, typical of virtually all such mortgages.

It is not the academic whereabouts of "legal title" that is important in determining whether a document labeled a conditional sale is a mortgage or an option, but whether the purchaser has agreed to go through with the purchase or has merely taken an option whereby he may purchase or may drop the matter. "Conditional sale" becomes an

ambiguous term where applied indiscriminately to (1) an agreement like the present that is a mortgage; or (2) a bailment where the bailee may purchase at his option, keeping the property if he elects to buy, otherwise returning it, title remaining in the bailor unless and until the option to buy is exercised; or (3) a "sale or return", where title passes to the purchaser but with an option in the latter to return the property. Categories (2) and (3), i.e. the bailment with option to buy, and the sale with option to turn back, are not mortgages; but using the caption "conditional sale" on all three confuses the distinctions. Here there was no bailment and no option to return.

Sturm v. Boker, 150 U.S. 312, 328, 14 S. Ct. 99, 37 L. Ed. 1093, 1100.

Hunt v. Wyman, 100 Mass. 200.

Steinhauer v. Henson, 54 Colo. 426, 429, 131 Pac. 255.

Bouvier's Law Dict., Baldwin's Century Edition (1926) on "Sale or return", last paragraph, citing *Sturm v. Boker*, 150 U.S. 312.

Bouvier defines a conditional sale as "a sale in which the transfer of title is made to depend upon the performance of a condition"; and in the case of any mortgage the transfer (re-transfer or release) of title from mortgagee to mortgagor is made to depend upon the performance of the condition, namely, payment. And Bouvier, in the course of a long article, defines a mortgage as:

"A conditional conveyance of land designed as a security for the payment of money, the fulfillment of some contract, or the performance of some act, and to be void upon such payment, fulfillment or performance. 44 Me. 299."

Both the court below and the Tax Court wholly disregarded, and did not attempt to answer, the unanimous opinion of this Court, which has never been modified or questioned (*Shep. Cit.*), in *Chicago Railway Equipment*

Company v. Merchants National Bank, *supra*, 136 U. S. 268, 10 S. Ct. 999, 34 L. Ed. 349, 352-3. This Court's decision is not mentioned in either opinion below (R. 30-36, 41-47), although strongly urged and relied on, in both courts, by the petitioner (R. 37, 52). It unanimously holds and strongly declares that agreements like Exhibits M and N are mortgages.

III. DEFINITE QUESTIONS OF LAW ARE INVOLVED, ALL FACTS BEING AGREED.

As in the lower court, the respondent may here seek to avoid a review by this Court, under the principle of *Dobson v. Commissioner*, 320 U.S. 489, 64 S.Ct. 239, 88 L. Ed. 248, and *John Kelly Co. v. Commissioner*, 326 U. S. 521, 66 S. Ct. 299, 90 L. Ed. 278. These decisions do not apply, because they involved complicated factual conclusions sought to be reviewed, and not a legal question as does the present controversy. In the *John Kelly* case, the majority opinion says, on page 529 of 326 U.S.:

*** courts must interpret the review statute as best they can to accomplish the declared Congressional purpose of adequate control of administrative action without substituting judicial opinion for that of the Tax Court *upon the evidence.*"

In the earlier *Dobson* case, the court, after discussing at length the complicated factual questions resolved by the Tax Court, said on page 502:

"In view of the division of functions between the Tax Court and reviewing courts, it is, of course, the duty of the Tax Court to distinguish with clarity between what it finds as a fact and what conclusion it reaches on the law."

At bar the facts were all stipulated, and the conclusions were wholly legal. This is the opposite of the *Dobson* case, where a complicated accounting problem was involved, and the court said further, on page 504:

"What, in the circumstances of this case, was a proper adjustment of the basis was thus purely an accounting problem and therefore a question of fact for the Tax Court to determine. Evidently the Tax Court thought that the previous deductions were not altogether 'properly chargeable to capital account' and that to treat them as an entire recoupment of the value of taxpayer's stock would not have been a 'proper adjustment'. We think there was substantial evidence to support such a conclusion."

At bar, the agreed facts all appear in a short record, and nothing is disputed except the legal conclusions to be drawn from admitted writings and circumstances. The present legal issues are peculiarly appropriate for lawyers rather than for accountancy experts, and they present questions on which such experts might perhaps be especially liable to fall into error.

CONCLUSION

It is thus apparent that the contracts are within the meaning and intention of Section 719 (a) (1), both as a note, bond, debenture or certificate of indebtedness, and also a mortgage or deed of trust; and if in effect they are either, or fall within any of those terms, then the exclusion of the \$221,476.59 as borrowed invested capital was erroneous and the prayer of the petitioner should be granted.

Respectfully submitted,

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